https://www.financial-planning.com/news/why-direct-indexing-is-gaining-ground-with-some-advisors

The 'granular' investing strategy with big tax savings for HNW clients
By Rob Burgess
July 09, 2025, 11:07 a.m. EDT

On one end of the spectrum is passive investing; on the other, active. And somewhere in between sits direct indexing.

For clients looking for precise control over their portfolios, the strategy can be a solid middle ground between the mass-market ETFs and high-maintenance stock picking, said Eric Croak, president of Croak Capital in Toledo, Ohio.

"Direct indexing is really just owning the pieces of an index instead of the ETF shell," he said. "So instead of one fund that tracks the S&P 500, you hold all 500 companies, or at least enough to mirror its performance."

For Tushar Kumar, co-founder of Twin Peaks Wealth Advisors in San Francisco, it's his fastest growing strategy for client portfolios. Direct indexing gives his firm a toolkit that's flexible, tax sensitive and aligned with the circumstances and priorities of each client.

"I'm generally a big fan of direct indexing, particularly for clients with significant capital gains exposure or concentrated equity positions," he said.

However, it's not a magic bullet, and it works best when the investor has the interest and resources to make it worthwhile, said Trevor Johnson, financial planner and founder of Dream Weaver Financial Planning in Richmond, Illinois.

"Direct indexing can be a powerful strategy for certain investors who want more control, customization and potential tax benefits than traditional ETFs allow," he said.

The ability to offset gains in other accounts or funds and then donate the appreciated shares is powerful, said Rob Schultz, senior partner and wealth manager at NWF Advisory in Encino, California. Schultz recently helped a client donate about $35,000 of Tesla stock with a cost basis around $1,200.

"With the costs and minimums, there is a compelling case for those in higher tax brackets and with charitable inclinations," he said.

Tax-loss harvesting possibilities
One of the biggest advantages of direct indexing is automated and systematic tax-loss harvesting throughout the year, said Kumar.

"Instead of scrambling in December to find losses, the platform continuously monitors for opportunities to harvest losses, which research has shown can be

more impactful than year-end-only strategies," he said.

The ability to tax-loss harvest individual "losers" is a huge advantage, said Croak.

"That can shave thousands off your bill when it's done right," he said. "It's granular investing for people who care about line-item details."

But unless you are working with a sizable portfolio, that effort can be overkill, said Croak.

"If you are investing $50,000, it's probably a solution in search of a problem," he said. "But once you are over $500,000 and sitting on capital gains elsewhere, direct indexing can offset real dollars. Think $10,000 in harvested losses generating $2,000 to $3,000 in immediate tax relief. Do that every year, and you are stacking a serious advantage."

Increased portfolio customization

What draws Jon Wingent, principal at Cerity Partners in Los Angeles, to direct indexing is the ability to truly tailor a portfolio to the individual.

"It's not just about tracking a benchmark or chasing performance — it's about helping clients align their investments with their goals, values and personal tax situation in a way that feels intelligent and intentional," he said.

Many clients don't realize that ETFs come with baked-in expenses, said Christopher Hensley, president and CEO of Houston First Financial Group in Bellaire, Texas.

"They might see a low advisory fee and think that's the whole picture," he said. "But inside those ETFs are costs that quietly eat away at returns. When I'm managing a non-retirement account in a fee-based setup, and trading isn't an issue, direct indexing can be cheaper — and more customized."

Direct indexing also defrays one of the inherent problems of using an index fund or ETF — inflexibility in taking advantage of losses in the underlying basket or fund, said Robert S. Jeter II, vice president and financial advisor with InFocus Financial Advisors in Salisbury, Maryland.

"For high-tax investors, it can be a great way to keep more of what you earn or compound over time," he said.

Values-based investing

The ability to personalize a portfolio underscores another aspect of direct indexing: It can be incredibly useful for values-based investing, said Kumar.

"For example, many of our clients want to align their portfolios with environmental sustainability, so we're able to exclude companies or industries that don't align with their values," he said.

Direct indexing allows the flexibility to screen out individual stocks for any reason: moral, strategic or tax-related, said Croak.

"Want an S&P 500 portfolio with zero oil companies? Fine," he said. "Hate banks? Cut them. You still track the market, but you skip the noise. Just remember, tracking error is real, and if you slice out too much, you are no longer replicating anything meaningful."

This form of values-based investing is called negative screening, said Ty Johnson, a financial planner with Peak Financial Management in Broomfield, Colorado. The challenge is that investors' personal values can differ widely, he said.

"Even when investors have a common approach … they can have disagreements on exactly what should be screened and what shouldn't," he said. "This makes it difficult for fund providers to offer values-based ETFs or mutual funds with a values set that many investors can agree on. Direct indexing solves this problem by allowing each investor to customize their portfolio based on their unique values."

Potential downsides to direct indexing

Direct indexing can be a smart strategy for some investors, said Luke Harder, a financial advisor at Claro Advisors in Boston. But as a one-size-fits-all solution, it's being oversold.

"It's best suited for investors looking to deconcentrate a position or manage a specific tax liability, not something that belongs in every portfolio," he said.

One of the disadvantages of direct indexing is the lack of simplicity, said Croak.

"You need good tech or a sharp team," he said. "This is not something you DIY with a spreadsheet and weekend brainpower. It requires ongoing rebalancing, tax lot tracking and smart automation. Otherwise, the whole thing collapses under complexity."

Cost-wise, direct indexing is also usually 0.25% to 0.50% on top of whatever else you are paying, said Croak.

"So, you need to get real value back," he said.

Clients who do use direct indexing will generally own hundreds of individual stocks versus a handful of ETFs, said Kevin J. Brady, senior vice president and advisor with Wealthspire in New York City.

"That can make tax reporting more costly and burdensome. This is why you only want to pursue direct indexing for someone who is and will remain in a high tax bracket and has enough assets where it makes sense."

Another potential downside is that clients may not be diversified in terms of market capitalization, geography or bonds, said Samantha Mockford, associate wealth advisor with Citrine Capital in San Francisco.

"If your entire investment portfolio's growth mirrors, say, the S&P 500, then any events that impact large U.S. companies, for example, new tax legislation, will tank your whole financial plan," she said. "If you need that money sooner, then it would be wise to mix in some diversified bonds, as well."

Is direct indexing right for a particular client?

Kevin Newbert, a financial advisor with Ausperity Private Wealth in Moorestown, New Jersey, said his firm evaluates the fit based on the client's tax profile, concentration risk and whether the assets are in taxable accounts large enough to warrant the operational complexity.

"For the right client, the after-tax benefits are significant and measurable," he said.

Advisors should ensure the client's account size meets minimum thresholds, which are usually $100,000 and above, said Brandon Thomas, co-chief investment officer and co-founder of Envestnet | PMC, the portfolio management consulting group of Envestnet.

"The client should also feel comfortable owning potentially small amounts of a few hundred securities, as opposed to a single ETF," he said.

If a client is in a high marginal income tax bracket, direct indexing is worth considering to take advantage of short-term losses, which can offset $3,000 of ordinary income per year and can be carried forward to future tax years indefinitely, said Jake Skelhorn, partner and wealth advisor at Spark Wealth Advisors in Jacksonville, Florida.

"But if your net worth is under $1 million, you could argue that the juice rarely justifies the squeeze," he said.